



To the Town Board
Town of Frederick

In planning and performing our audit of the financial statements of the Town of Frederick (the "Town") as of and for the year ended December 31, 2009, in accordance with auditing standards generally accepted in the United States of America, we considered the Town's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Town's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies in the Town's internal control to be material weaknesses:

Check Stock and Signature Stamp

During our walkthrough procedures, we noted that the Town uses signature stamps. Also, the Town uses blank check stock for computer generated checks. The check stock was not maintained in a secure location, thereby weakening the internal controls over cash disbursements. We recommend that the signature stamp and blank check stock be maintained in a secure location, such as a locked filing cabinet, and that only certain personnel have access.

As noted above, the Town is utilizing a signature stamp. While this may be appropriate for normal reoccurring checks, we recommend that the Town establish a predefined check limit, where a stamped signature will not be accepted, and a manual signature is required. This will greatly strengthen controls over large cash disbursements.

Year End Accruals

During our audit, we discovered that payroll related accruals are not reviewed at year end. We therefore recommend that, in lieu of more effective checks and balances in this area, the accrual be reviewed and approved by a person one level higher than the person making the adjustments to the general ledger. This review should be documented and maintained with the journal entry for the accrual. The Town staff has addressed this issue and has procedures in place to require approvals for all year end accruals.

Accounts Payable

While performing the search for unrecorded liabilities, we noted the Town did not properly record payables for year-end. Proper cutoffs are critical for the accuracy of financial statements, prepared using the accrual basis of accounting. These cutoff problems were the result of the contract accountant from Casellé not being aware of the need for proper cutoff of accounts payable at year end. We recommend that the Town establish prepare written instructions to be included as a part of the Town's accounting policies and a procedures manual that indicates basic concepts of proper cutoffs and the individuals responsible for accruing payables at the accounting period end.



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A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the Town's internal control to be significant deficiencies:

Monitoring

Currently, the Town is not actively monitoring controls over financial reporting. Monitoring and review of transactions is an important feature of the Town's internal control. While we clearly understand the limitations on obtaining an adequate segregation of duties with such a small staff, we feel that a person outside of the internal control process should conduct periodic surprise reviews over the internal control process. This review should include testing controls around cash receipts, cash disbursements and payroll at a minimum.

Financial Statement Close Process

In an effort to improve the quality of monthly and annual financial information, we recommend that the Town adopt a formal financial statement close process, which identifies specific accounts that require periodic reconciliations; assigns functions to responsible individuals; outlines deadlines for completing specific functions; and indicates those who are responsible for reviewing and approving individual reconciliations and reports. This process may be documented in the form of a "Closing Checklist" where the completion of these procedures may be evidenced by initials and dates of the responsible individuals. It is our understanding the Town staff is in the process of preparing a document to address this issue.

Evidence of Review and Approval

While performing our walkthrough procedures of the internal controls of Town we noted that evidence of the review and approval process is not being maintained by the Town. There are a number of control activities which rely on these processes. Without proper documentary evidence, it cannot be confirmed that these procedures are occurring. We recommend that the Town adopt a policy of requiring initials and dates for the performance of all duties, reviews and approvals. This will ensure a proper documentation of the review and approval process.

Review and Approval of Nonstandard Journal Entries

During our walkthrough procedures, we noted that journal entries are written and posted to the general ledger by one person and that there is no review or approval of those journal entries. We recommend the journal entries be printed monthly and be approved by the administrative services director or the Town administrator. This would improve controls over adjustments to the general ledger.

Vendor File Maintenance

As part of our fraud procedures, we reviewed the list of vendors used by the Town and found a number of them had not been used in recent years, and many did not list an address. We recommend that the Town assign a staff member to review the entire vendor list and either eliminate, or place in an inactive status, the vendors on the list which the Town is not currently using. We also recommend that the Town require complete information for all vendors entered into the accounting system.

Accounts Receivable Collection Procedures

While conducting our audit, we noted that the water fund accounts receivable balances had increased 48% percent from December 31, 2008. This creates a potential for future uncollectible accounts. We suggest that the Town increase their efforts in the collection process to mitigate the risk of uncollectible accounts.

Net loss in New Venture

During the year the Town began providing trash removal services for the citizens of Frederick. The expenditures for this venture exceeded revenues by appropriately \$111,700. We recommend that a more thorough analysis of the expected costs to provide this service be done and revenue rates be adjusted if necessary.

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This communication is intended solely for the information and use of management, the Town Board, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Watkins & Schommer, Inc.

Watkins & Schommer, Inc.
Greeley, Colorado
September 22, 2010